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With a brief history provided, the free trade agreement between the two countries is analyzed in context of the internal benefits to Mexico and the overall economic strategy the U.S. is pursuing in Latin America.

Lastly, the forces for and against the agreement within the U.S. are analyzed with the projection that the agreement will be approved in 1993, after the Presidential elections.


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USAWC MILITARY STUDIES PROGRAM PAPER



# THE CHANGING FACE OF UNITED STATES-MEXICAN COMMERCIAL RELATIONS AND THE FREE TRADE ISSUE

**AN INDIVIDUAL STUDY PROJECT**

by

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# ABSTRACT

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## INTRODUCTION

> *There are other pairs of countries where destinies are intertwined. These include Canada and the U.S., France and Germany, Australia and New Zealand. But in no other case has fate placed populous countries so disparate in levels of economic development and cultural tradition next to each other as Mexico and the United States. These differences make the challenge of cooperation extremely delicate and difficult but geography leaves no other choice.*
>
> --- *Sidney Weintraub*

The debate on the questions of free trade with Mexico rages on. One might ask why all the fuss? After all, the United States (U.S.) and Canada signed a free trade agreement in 1989. If it was mutually advantageous to sign an agreement with our Northern neighbor, why not with our Southern neighbor? Sidney Weintraub's observation above reveals some of the unique challenges that engulf the free trade issue with Mexico.

The interests of the U.S. and Mexico are quite different. Relations between the countries can be characterized over time to include mistrust on the one hand (Mexico) and indifference on the other (U.S.). To examine the free trade issue of today, we will start by reviewing the past twenty years. The first fifteen years, from 1970 to 1985, comprise what I call the "Failed Years," a period that found Mexico desperately trying to grow and prosper from within while the U.S. focused externally on the bipolar struggle. Out of necessity, Mexico began to change its economic strategy.

We will examine this transition period (1985 to 1990), which witnessed significant changes in how the two countries view each other. Understanding this transition period enables

us to examine the issue of free trade. The transition bridged the failed years and created the new open market environment of today. Next, we will discuss the benefits--for both sides, in varying degrees--of this new situation. Finally, an assessment of the role the free trade agreement will play in the future--for both countries and the rest of Latin American--concludes the essay.

## THE FAILED PAST--1970-1985

> *Poor Mexico, so far from God, so close to the United States.*
>
> --- *Diaz*

For nearly two decades, the U.S. has focused its attention on the bipolar world of post World War II superpowers. Everything from economics to cultural exchanges was measured in terms of its impact on this bipolar competition. During this same period, as the U.S. focused externally on Communism and the USSR, Mexico's focus was almost exclusively internal. Common borders connect the U.S. and Mexico. Unfortunately, there are few other examples where the neighbors connect. Foreign policy, ideological positions, and economic policies are as disconnected as one could imagine. It is little wonder that the fifteen-year period 1970-1985 is called the "Failed Past" in terms of U.S.-Mexican relations.

A review of each country's focus during this period makes this failure apparent. It will enable us to appreciate the hurdles that need to be jumped, to evaluate the current state of

affairs, and to draw some conclusions for the future. This brief review will cover each country's primary focus during these fifteen years, including an examination of economic policies for the same period. Lastly, the perceptions of many Americans and Mexicans for each other reveal interesting insights.

In general terms, the U.S. focus or primary concern during the 1970s and most of the 1980s concentrated externally on the threat of worldwide communism as fostered by the Soviet Union. In Latin America, this bipolar struggle was played out primarily in Nicaragua and El Salvador. President Reagan's policies in Latin America centered on these two countries, where the ideas of capitalism and communism were locked in struggle. Little or no U.S. effort or concern appeared to surface beyond these two countries. While U.S. attentions were externally focused on bipolar ideological struggles, Mexican concerns were internally focused on economic matters.[1]

Mexico's internal developments consumed the overwhelming energies of its Presidents in the 1970s and 1980s. Mexico's unique "development-from-within" model featured a large state sector, a protected industrial structure, a limitation on direct foreign investments, an overvalued exchange rate that permitted imports of needed capital goods at what amounted to subsidized prices, and a requirement to purchase most intermediate goods used for production from within Mexico.[2] This plan failed miserably and may have actually made the economic situation worse. This plan resulted in one of the most unequal patterns

of income distribution in Latin America.[3] The plan also failed to create jobs in a country where over one million new workers enter the work force each year.[4]

America's near total disregard for Mexico and Mexico's nearly disastrous economic programs were influenced by each country's negative perceptions of the other. Many Mexicans view the U.S. as dangerous and exploitive. This perception gives credence to the dependency theory, a theory widely held by many Mexicans--especially academicians in both countries. This theory basically asserts that any increases in economic dealings between the two countries results in further U.S. dominance over the Mexican economy. American perceptions of Mexico center on the corrupt nature of the government and the racial view that Mexicans are "different." These perceptions are probably most widely held in the general population than in government circles. But nevertheless, these perceptions are "real" and do have an influence on state-to-state relations.[5]

The war on drugs has recently drawn the attention of the U.S. to Mexico. The net effect of this attention is no doubt negative. The Mexican people and government probably view drug abuse as an American problem and an American excuse to meddle in Mexican affairs. Americans, on the other hand, come away with the strengthened perception of Mexican corruption.

Thus far, American dealings with Mexico can be characterized by indifference in terms of the bipolar struggle and as a minor irritant in terms of the drug war. Mexico, in the meantime, has struggled to find an answer to its internal

economic development problems. But Mexico believes that the U.S. has been part of the problem, not a potential part of the solution.

Given this setting, let us move closer to the central issue of trade, particularly U.S.-Mexican commercial relations in the 1970s and 1980s. Despite the significant differences we have noted, strong and substantial trade relationships exist between the two countries. The U.S. is Mexico's dominant trading partner. The U.S. receives 65-70% of Mexico's exports,. and 60-65% of Mexico's imports come from the U.S. Mexico is the third largest export market for the U.S.--Canada is first and Japan is second. However, U.S. exports to Mexico in 1981 represented only 7.6% of total U.S. exports. U.S. imports from Mexico in 1981 represented only 5.3% of the total U.S. imports. Thus, Mexico is much more dependent on trade with the U.S. than the U.S. is dependent on trade with Mexico.[6]

This lopsided trading relationship helps explain Mexico's keen interest in everything we do economically, and the U.S.'s apparent indifference to the economic plight or policies of the Mexican government. In fact, throughout the 1970s and early 1980s, the U.S. did not have specific policies toward Mexico. However, the absence of such policies did not stop the U.S. from inadvertently undermining the Mexican economy. In fact, lack of U.S. policy may have been part of the problem. For example, when the U.S. raised its interest rates in the early portion of the Reagan Administration, Mexico's debt service obligations were increased at the same time oil prices fell sharply. As the

U.S. inflation rate decreased, the result in Mexico was that the real cost of debt servicing in dollars was higher than expected. But not all U.S. policies hurt Mexico. A positive spin-off from the growth of the U.S. economy in the 1980s provided Mexico an outlet for exports. By the mid-1980s, a trend in U.S. economic relations with Mexico began to take shape. The attitude of indifference was slowly replaced by an attitude toward protectionism.[7]

This piecemeal movement toward protectionism by the U.S. prompted Mexico to start a country-to-country dialogue. In 1985, a U.S.-Mexican agreement on subsidies and countervailing duties came in response to a series of fair trade positions directed at imports from Mexico. In November 1987, a trade understanding agreement was signed between the two countries. This agreement permitted, in fact encouraged, consultations on each other's trade practices within thirty days of a request. The agreement also called for immediate discussions on textile, agriculture, steel, and electronic products. As a result of the established structure for dialogue, a new textile agreement was reached and Mexico achieved a modest increase of its steel quota for the U.S.[8]

Summarizing the trade policies between the two countries, we find Mexico protecting its internal development program with barriers and tariffs in the 1970s and early 1980s. The U.S., on the other hand, had no specific policies vis-à-vis Mexico. In response to Mexico's protectionism during this period, the U.S., in general terms, would preach free trade. In the mid-1980s, a

reversal of positions starts to occur. Mexico begins to open up its markets and the U.S. starts to protect its markets. Thus, the period of transition begins.

## THE PERIOD OF TRANSITION--1988 TO PRESENT

*The United States is the only industrial country that shares a border with a developing country.*

*--- Alan Stoga*

During this transition period, there is little doubt that dramatic changes have occurred between the U.S. and Latin America in general, and the U.S. and Mexico in particular. In fact, one could say that the changes in U.S. attitudes and policies toward Latin America are being spearheaded by the new relationships being forged between Mexico and the U.S. What catalysts have brought about this transition, catalysts so strong that decades of the status quo have been openly and unequivocally discarded? The new world order, globalization of the world's economy, and Mexico's failed economic programs have combined to change, perhaps forever, the U.S.-Mexican political and economic relationship.

Let us briefly examine the forces at work in Mexico that led up to this transition period--for it is Mexico that has taken the lead in the quest for change. President Madrid recognized, in the last part of his Presidency, that the Development-from-within Program was a failure. He feared that continued failure would threaten the very survival of the ruling PRI. What brought this program to its knees was the increase in

interest rates in the early 1980s coupled with falling petroleum prices. Mexico's foreign debt reached one hundred billion dollars and no new loans were possible. This one-two punch brought President Madrid to the most pivotal point in recent Mexican history. His choice was either more of the same which would threaten the very future of the PRI; or he could seek new ways to get out of debt. Getting out of debt meant increased exports and foreign investments.[9]

Increased exports and foreign investments may be obvious solutions, but the risks associated with these solutions were very large and real to political observers of Mexico's recent past. Mexico, for the past fifteen years, has been the most nationalistic country in Latin America. This political doctrine translated into economic policies which dictated that Mexico would pull itself out of its third world status with no help or meddling from outsiders, especially the U.S. So when President Madrid pushed for increases in exports and foreign investment, both solutions surprisingly pointed to the U.S. We have noted that the U.S. is Mexico's biggest export market. And we will soon see that the U.S. would be the primary source of foreign investment.

Madrid, facing those fundamental changes in political doctrine toward the U.S., faced as well considerable risk in attracting either increased export markets or foreign investments. But these risks were necessary. First, Mexican industries were competitive weaklings, isolated by protectionism, and propped up by large government subsidies.

Second, Mexico's potential export market, the U.S., was leaning more and more toward protectionism itself. But President Madrid had little choice. If the PRI was to stay in power, he had to change some things.[10]

In the last two years of his six-year term, President Madrid initiated the much-needed transition. He opened up the economy and signaled that this change was permanent when Mexico was officially brought into the General Agreement on Tariffs and Trade (GATT) in 1986.[11] There is little doubt, then, that President Madrid started the transition of the Mexican economy. But his successor has been credited with the vision and drive to accelerate this transition to the point it has reached today. Likewise, a new President of the United States played an important role in supporting and expanding this transition.

In sporting terms, this transition period brought new players to the game--Presidents Salinas and Bush. This game would be played on a new playing field with a new set of rules.

President-elects Salinas and Bush met in Houston, Texas, in November 1988, shortly before each started their tours of office. Each player brought a style of play and experience that facilitated the transition. President Salinas brought to his leadership role an economic savvy unequaled by most heads of state. He received his MBA from Harvard, a degree suitably matched to his country's most pressing challenges.[12] Young and politically astute, he combined these talents to make a quantum leap off the springboard provided by President Madrid. So, we have a President eager to thrust Mexico into the world market--a

market dominated by the U.S. His counterpart, newly-elected President Bush, complemented President Salinas in purpose and style. President Bush, strong supporter of free trade, was a natural team player in Salinas' plan to push Mexico into the world marketplace. President Bush's pragmatic, collegial style of doing business no doubt helped to facilitate this team effort. Thus, elections in both countries brought new players, Bush and Salinas, into the game.

But in addition to the new players, the playing field had changed. In the past forty years, the playing field for the U.S. was the turf upon which the bipolar struggle was waged. For Mexico, the playing field was a weak and faltering closed economy. For the U.S., the fall of communism, free elections in Nicaragua, and Operation JUST CAUSE all helped President Bush look at Mexico in a different light.[13] In Washington's view, the global playing field no longer hosted games of ideological struggles. In the context of the New World Order, the new playing field hosted contests of economic competition. So, for predominantly external reasons, President Bush chose to compete on this new economic playing field. President Salinas chose the same playing field for primarily internal reasons.

President Salinas ha: been committed to the new game and playing field by his predecessor when Mexico opened its markets and joined the GATT. President Salinas chose the U.S. as its playing partner, in part, because the other major players--the EC and Japan--were busy building up their respective team members. In 1989, President Salinas sought foreign investments

from Japan and the EC. However, he soon realized that the EC was fully committed to the struggling economies in Eastern Europe; and, further, Japan's primary emphasis was focused in countries in Asia and the Pacific Rim.[14] The bulk of the foreign investments would thus have to come from the U.S. So Mexico and the U.S. chose this new playing field for different reasons. For Mexico, this new field represents the best chance to turn economic defeat at home into victory. For the U..S., this new playing field no longer hosts games of ideological dominance; rather, it provides an arena for economic free trade where all teams play by the same rules (GATT). Joined together on this new playing field, each country has developed a game plan to achieve success.

Strategies enable players to reach goals; but strategy is driven by the value players attach to the goals. How important is victory? In the case of Mexico, overwhelming necessity--economic and political survival--has been driving its strategy. In the case of the U.S., the game plan or strategy has not developed out of fear for political survival or economic necessity. In fact, if being a good neighbor is a strategy, then the U.S. and President Bush had a strategy toward Mexico. When the two President-elects met in Houston in late 1988, one came as a neighbor and the other came out of necessity. Thus, it is not surprising that President-elect Salinas came with a specific agenda to meet his neighbor to the North; whereas President-elect Bush greeted him with little more than a broad smile and a pat on the back.

Salinas' agenda for the meeting was no doubt part of a larger, three-pillared strategy. First, he sought to continue economic reforms, but at an accelerated pace. Second, he needed to obtain relief from the foreign debt. And, third, he worked to establish a new relationship between the U.S. and Mexico, in part, to help accomplish the first two objectives.[15]

During the "Spirit of Houston" meeting, bilateral relations were discussed in a general context while the debt problem was discussed in some detail. President Salinas' strategy bore near-immediate results on the debt issue. Shortly after taking office, President Bush directed Secretary of the Treasury Brady to develop a new debt strategy for Latin America. The resulting Brady Plan, financed with reprogrammed World Bank and IMF resources, added voluntary debt and debt service reduction to the options available to bank creditors and debtor nations. Although the Brady Plan may not have been designed for Mexico in particular, Mexico was the first to take advantage of it.[16]

The Brady Plan enabled Mexico to sign a new debt agreement --covering the entire $48 billion of medium and long-term debt owed to commercial banks. This agreement reduced the potential shock effect of future interest hikes by converting almost half of Mexico's floating interest rate debt to fixed rate securities. The agreement also provided substantial cash flow benefits created by interest rate reduction and new borrowing. But perhaps most important, the agreement was a confidence builder. Less worries over the debt helped create and sustain optimism in foreign and domestic investors. As a result,

interest rates on the peso dropped sharply and the government's huge interest bill was reduced. So President Salinas' game plan, initiated during the Houston meeting, started to bear fruit.[17]

A partial solution to the debt problem was welcomed, but accelerated economic reforms--growth in the economy--needed new capital inflows. Mexico's options are somewhat limited in attracting capital inflows. In a way, the government is caught in a Catch 22 situation. One of the best ways to attract investment capital is through sustained economic growth. But given Mexico's many challenges, real, sustained economic growth cannot be realized without capital inflows. A partial solution for raising capital is privatization, a method that Mexico started and one which the rest of Latin America has followed. But what happens when you run out of industries to capitalize? The Mexican government estimates that foreign investments will total no more than $4.5 billion annually by the mid-1990s.[18] In 1989, foreign investments were pegged at $2.9 billion.[19] Is this projection enough to achieve the economic growth required by Mexico? President Salinas obviously thinks not. So, what other options does he have to shore-up his economic reforms, reforms that are closely linked to the confidence of foreign investors? President Salinas' revealed his solution in the spring of 1990 when he proposed a free trade agreement with the U.S.

## THE DEBATE--FREE TRADE WITH MEXICO

> *Geography has made the relationship between the United States and Mexico the most important one for Mexico and one of the most important, if not the most significant for the United States.*
>
> --- *Sidney Weintraub*

President Salinas, once again the initiator, proposed a free trade agreement with the U.S. in the spring of 1990. Couched in New World Order terminology that would appeal to President Bush, Mr. Salinas stated:

> The changes in Europe and East Asia, and on apparent reliance on blocs, convinced me that we should also try to be part of an economic trading bloc with the United States and Canada. But we do not want this bloc to be a fortress. We want it to strengthen our ability to be part of Asia, Europe, and especially Latin America.[20]

Although President Salinas expressed the free trade proposal in terms of the New World Order, his real reasons centered on the positive economic and political impacts the FTA would have in Mexico.

First and foremost, the FTA would help ensure continued growth of the Mexican economy. Continued growth relies on increased foreign investments, and confidence in the Mexican economy drives foreign investments. The FTA serves as a symbolic guarantee of the nature of changes in the Mexican economy.[21] Confidence also is critical in domestic investing. One Mexican economist stated that any delays in signing the FTA would threaten the financing of all those investment projects to which the Mexican private sector is committed.[22]

If a FTA's biggest benefit is psychological--a confidence builder--what other benefits would Mexico derive from its signing?

The FTA appealed to Mexico for the same reason it appealed to Canada. This appeal was not focused so much on additional free trade, but on not losing any more trade benefits because of increased barriers being erected by the U.S. In fact, Mexico and Canada saw the handwriting on the wall; they viewed the FTA as a means to thwart a rising mood of protectionism with the U.S. But, over time, FTA also offers the positive advantages of reducing and eventually eliminating non-tariff restrictions, particularly on industrial products such as textiles and apparel.[23]

In addition to the economic advantages inherent in the FTA, President Salinas also stands to reap certain political benefits by a FTA--enhanced economy. The continued growth of the Mexican economy enables President Salinas to provide some benefits to the Mexican people, whose expectations have not been satisfied, thus far, by the trickle-down theory of income distribution.

Two groups represent the largest potential threat to the Salinas government--the poor at the bottom of the economic ladder and the group that expects to leave the have-nots and migrate up the ladder to the middle class. The World Bank estimates that one in five Mexicans lives in abject poverty, with annual incomes of less than $250.[24] According to the Mexican government's own estimates, 40 out of 88 million Mexicans are classified as poor.[25] The much more dangerous group

is the population who expects to cross the line from the poor to the middle class. The recent coup attempt in Venezuela was staged, in part, because four years of dramatic growth had not produced any trickle-down benefits to the have-nots.[26] Some key Venezuelan Army officers who attempted the coup rightfully perceived the rich getting richer.[27] In Mexico, privatized state assets also are making the rich richer, and little of the growth experienced thus far has trickled down. To help the have-nots, President Salinas originated an anti-poverty program called Solidarity. This program earns high marks from foreign aid experts. In fact, the U.S. government soon will lend $350 million for a regional development program under Solidarity's auspices.[28] The Solidarity program helps the very poor and the economy can hopefully sustain its growth to fulfill the expectations of the economic line crossers. Again, the FTA plays a big part in maintaining investor confidence, which fuels economic growth and makes trickle-down possible. Like Venezuela, Mexico's problems in this arena are not unique. The FTA presents hope to solve part of the expectation problem, just as a hemisphere-wide free trade agreement may help solve similar problems elsewhere in Latin America.

Mexico proposed the FTA to help ensure continued economic growth--growth critical to Mexico's hopeful future. But how does the FTA fit into the game plan of the U.S.? President Bush had no plan for Mexico, according to Robert Pastor who recently critiqued the Bush Administration's policies toward Latin America in an article in the Journal of Interamerican Studies

and World Affairs.[29] If one believes the Bush Administration did not have a specific game plan for Mexico, then the Bush Administration at least deserves partial credit for seizing the opportunities the FTA provided the U.S. government. Unlike Mexico, which primarily derives economic benefits from the FTA, the benefits derived by the U.S. are more diverse. These benefits run the gauntlet from the obvious--increased trade and other economic benefits--to the less obvious--increased cooperation in several peripheral areas, such as immigration and the environment.

Economically, the FTA provides an expanded market for U.S. exports, which have become a vital source of strength to the U.S. economy. In 1990, the nearly 8.5% growth in U.S. exports accounted for 88% of U.S. economic growth.[30] As the Mexican economy grows due to increased investor confidence and increased trade, the Mexicans will have more money to buy our exports. A prosperous and budding economy of 88 million potential consumers would help sustain the growth in U.S. exports, especially at the time the European economy appears to be losing momentum and poses the specter of a Fortress Europe that could potentially keep out U.S. exports.

A growing Mexican economy, particularly an expanding manufacturing sector, means more jobs for Mexicans. With close to one million laborers entering the job market each year, each new job in Mexico helps to reduce the immigration flow to this country. Sustained, dynamic growth might even induce reverse

migrations back to Mexico. President Salinas has observed that "if we cannot export our goods, we export our people."[31]

Looking beyond advantages accrued in trade and possibly in immigration patterns, the FTA also contributes to President Bush's New World Order. The growing economic strength of the EC and Japan may be partially offset by the FTA as the U.S. looks at the future's globalized, world market. With specific regard to Japan, the FTA also may help to reduce the rate at which Japan investments are pouring into Mexico and throughout Latin America. Significantly, prior to the Mexican proposal of the FTA, three hundred opinion setters in Mexico preferred Japanese investments in their country over those from the U.S.[32]

The EC and Japan aside, how does the FTA fit into the Administration's plans for the rest of Latin America? President Bush may not have had a specific plan for Mexico. Even so, shortly after President Salinas proposed the FTA, the Bush Administration quickly announced the Enterprise for the Americas Initiative (EAI). In terms of trade, the EAI used the FTA as a starting point and President Bush proceeded to outline his vision for Latin America. This vision, as set forth in the EAI, included a proposal for a hemisphere-wide free trade system extending from Anchorage to Tierra del Fuego.[33] The response to this initiative from Latin American leaders was immediate, enthusiastic, and overwhelmingly supportive. While the U.S. proceeded to sign framework agreements with a total of sixteen Latin American countries--thus paving the way for a trade block embracing all the Americas--the Latin American countries did not

sit idly by. New trade pacts between countries in Latin America sprang up overnight and old agreements were revitalized. The Andes Pact, the most recent agreement, was signed in January 1992 between Venezuela, Colombia, and Bolivia; Peru and Ecuador will join within six months. A free trade agreement (MERCOSUR), originated in 1988 between Brazil and Argentina, was extended to Uruguay and Paraguay in March 1991. Two other pacts are in the works--the revitalized Central American Common Market and the floundering Caribbean Community.[34]

The overwhelming reason for these free trade agreements is not to enhance trade between Latin American countries. The real prize is eventual trade with the biggest potential export market--the U.S.[35] Achieving hemisphere-wide free trade depends on the successful completion of a FTA between Mexico and the U.S. Other Latin American countries are clamoring to be next. Mexico, sensing the need and the momentum of free trade in the hemisphere, signed a pact with Chile and plan free trade deals with Venezuela and Colombia.[36] So the importance of the FTA between Mexico and the U.S. extends throughout Latin America. The success of the EAI, the Administration's vision for the hemisphere, depends on the successful completion of the FTA. Stated another way, in terms of Latin American relations, it is politically prudent to bring the FTA to a successful closure.

The FTA serves different interests. For Mexico, the FTA represents a symbolic guarantee of Mexico's permanent departure from economic policies of the failed past. Thus, as a confidence builder, the FTA is a critical component to continued

foreign investment needed to keep the economy moving ahead. For the U.S., the FTA represents a new approach in dealing with our neighbors in the hemisphere, replacing the traditional anti-communist approach of the past.

But taking the FTA at its face value--an agreement about trade--how are each country's interests served purely in terms of trade? Mexico and the U.S. share different expectations regarding the agreement. Mexico's trade interests appear to be more negative or reactive in nature. If we accept the premise that Mexico sought the FTA for the same reason Canada did--to thwart rising U.S. protectionism--then that reason would seem to be reactive. From this perspective, the FTA seeks to avert future loss of trade, not to increase trade. On the other hand, the U.S. appears to approach the FTA, at least in terms of trade only, as a positive, proactive initiative. The U.S. stands to increase its exports to Mexico; thus, the agreement will contribute in a small way to the export-induced growth in the overall U.S. economy.

The FTA obviously offers trade advantages for both countries. But is the FTA beneficial to world trade? Two distinguished economists have examined FTAs in a macro-economic sense and offer their opinions. Dr. Krugman, from MIT, believes theoretically that the cost of free trade blocks outweigh the benefits. However, he believes blocks formed between neighbors --EC and NAFTA--are overall beneficial because geography matters in terms of transportation and communication costs. It is no surprise, then, that Dr. Krugman argues for a NAFTA, but is

skeptical about a hemisphere-wide free trade block. Mr. Bergston, Director of the Institute for International Economics in Washington, D.C., argues that as the transport and communication costs fall, the pull of natural traders is likewise diminished. According to Mr. Bergston, the fact that trade between the U.S. and Mexico is already expanding does not prove that a FTA would add much to the acceleration. Mr. Bergston concludes that a NAFTA might make things worse for Mexico once it is married to the mess of U.S. trade policies. Lastly, to emphasize the point, he believes that America's deal with Canada was a mouse in terms of trade liberalization. It is not surprising that two economists would have opposing theoretical positions on the FTA with Mexico.[37]

But, what about the pragmatists, who have studied the FTA in terms of dollars and pesos and jobs lost or gained? In 1991, Senators Bentsen and Rostenkowski requested the independent International Trade Commission (ITC) to prepare a study on the FTA. The resulting ITC study stated that the FTA would benefit the U.S. economy by lowering prices, increasing competition, expanding trade opportunities, and improving the ability of U.S. firms to exploit economies of scale. In terms of total real income in the U.S., there would be an increase because of the trade created by the FTA. Additionally, real income for skilled workers is expected to rise, and unskilled workers would probably enjoy a slight increase in real income. The ITC report concluded that the overall benefit for the U.S. economy would be positive.[38]

The real potential, however, lies in the future as the three economies improve their integration and efficiencies. The most comprehensive private analysis of the FTA was conducted by KPMG Marwick for the U.S. Council of the Mexico-U.S. Business Committee. This study concluded that the direct impact on the U.S. economy of removing trade and investment barriers is small. There would be gains and losses in some sectors but, overall, more than 50,000 jobs would be created in the U.S., a small number in terms of the entire U.S. labor market.[39]

Several insights can be gained from these studies. First, precise numbers-- and thus benefits--are tough to substantiate. ITC concluded the overall impact on the U.S. economy would be "positive," and the second study concludes the impact would be "small." Both conclude that the impact would be spread over ten to twenty years as the transition occurs. What is clear is that in terms of trade and the overall positive effects to their respective economies, Mexico appears to gain more than the U.S. But for the U.S., benefits in other areas--the environment, immigration, and the oil industry--must be factored into the equation. When these benefits are added to the "small" and "positive" benefits reflected in the studies, then the advantages appear to provide a win-win situation for both countries. President Bush obviously does not view the FTA as a zero-sum game. His New World Order and his vision for Latin America--expressed in the EAI--places the FTA in a much larger equation. Its value to these endeavors magnifies the seemingly small benefits in terms of bi-level trade relations.

But, will the FTA be approved by the three countries involved?

The environmentalists probably pose the biggest obstacle to passage of the FTA. In the past, environmental issues have surfaced in the course of trade discussions. But, for the first time, U.S. environmentalists, supported by their Mexican counterparts, have directly petitioned the Congress to require the President to include environmental issues in the negotiating agenda. This joint effort failed to get environmental issues on the official negotiating agenda. However, they did get the Bush Administration to make the following concessions: an environmentalist became part of the advisory body to the negotiating team; a commitment was made to pursue a parallel agreement on environmental quality; and a commitment was extracted to hold the line on protecting U.S. health, safety, and environmental standards.[40]

Caught off guard by the stiff opposition of environmentalists, Mexico took steps to demonstrate its concern for prosperity and the environment. In January 1992, the number of inspectors in the industrial corridor along the U.S.-Mexican border was doubled.[41] In the same border area, Mexico plans to spend $460 million over the next three years to clean up contamination and strengthen the infrastructure.[42] Last year, six hundred factories were partially and temporarily shut down because of pollution.[43] It is estimated that Mexico's environmental services will thereby expand to five to seven billion dollars in sales in five years from its current level of

$500 billion.[44] The U.S. also has taken steps to clean up its environmental policies.

On 25 February, President Bush announced a plan that will help ease the concerns of environmentalists vis-à-vis the NAFTA. In election year posturing, this will enhance his image as an environmental President. The "Integrated Border Plan" is designed to clean up the much polluted 1,600-mile border area with Mexico. This plan calls for $380 million in federal funds over two years to be dedicated to the problem.[45]

Surprisingly, all environmentalists are not opposed to the FTA. While the Sierra Club has been fearful of the agreement from the beginning, believing it will lead to the rapid industrialization of Mexico, others, like the Environmental Defense Fund, generally support the NAFTA despite some reservations on the speed at which environmental issues will be addressed. Supporters among the environmentalists believe more can be done for the environment in a growing, prosperous economy than in a declining economy.[46]

Even so, the Administration may have to make further concessions to the environmentalists as it did to obtain fast track authorization in 1990. Additional concessions, coupled with the division among the environmental groups, will probably enable the Administration to once again prevail in the final yes-no vote. However, an environmental disaster may unify the environmental groups and jeopardize the final passage.

Labor unions oppose the NAFTA. Surprisingly, this opposition from labor unions is not the banner carrier against

the agreement. This lesser status in the opposition camp may be due to the continued decline in union members and their political clout; but more likely it is due to their weak argument on the issues of jobs. One previously cited study by KPMG Marwick estimated an overall gain of 50,000 jobs in the U.S. A more recent study, quoted in the Financial Times (11 March) predicts FTA will create more than 600,000 jobs in Mexico and over 130,000 in the U.S.[47]

In Mexico, organized labor under the Mexican Workers' Confederation is guaranteed a quota of elected offices in return for disciplined adherence to the government's policies. This agreement suppresses rank-and-file efforts to form rival, more democratic workers' organizations outside the sphere of the government-controlled PRI. So President Salinas does not have the same worries about labor's opposition to the FTA as does President Bush.[48]

The rising mood of protectionism is probably the greatest potential threat to passage of the FTA. Presidential candidate Patrick Buchanan's protectionist theme appears to be playing well, especially when coupled to the current popularity of Japan bashing. In the senatorial race in Pennsylvania last November, the issue of free trade was raised by the eventual winner, Senator Wofford. However, the issue did not create as much interest as predicted, especially given Pennsylvania's reputation as a protectionist state.[49] At this stage of the election year, it may be too early and difficult to judge the

forces that may rally behind the protectionist banner and oppose the FTA.

The FTA has formidable foes--environmentalists, organized labor, and protectionists. But the forces in favor of the agreement are also formidable; they are proven winners in the fast track authorization vote. The growing political clout of the Southwest represents a very powerful political block in favor of the FTA. This region's economy is closely linked to Mexico. Texas, the dominant state exporter to Mexico in 1990, exported over $13 billion to the Mexican market--47% of the total U.S. shipments.[50] California followed Texas with $4.2 billion in exports to Mexico.[51] Mexico was Arizona's biggest export market in 1989.[52] The growing success of the maquilas along the border and the growing vitality of Monterey--the "Pittsburgh" of Mexico, located less than a day's drive from the border--have produced jobs and income. In turn, this new prosperity has generated millions of dollars of sales for U.S. retailers near the border.

In addition to trade across the border, demographics play a large role in the political equation. The Hispanic population is the fastest growing ethnic group in America. The vast majority of Hispanics live in the Southwest, and many have relatives in Mexico. A natural sympathy and supportive mood in this ethnic community favors the FTA--a mood politicians would be foolish to ignore.

Texas plays the dominant role in this regional block of states that support the FTA. The importance of Texas' electoral

votes plays heavily in Presidential elections. President Bush also claims Texas as his home state. All of this makes Texas the natural leader in the Southwest in the fight for free trade. It is not surprising that Senator Bentsen of Texas--along with Senators Packwood of Oregon and Baucus on Montana--has been instrumental in the passage of the fast track authorization in 1991.[53]

Another key player in favor of the FTA is the oil industry. This powerful industry supports the FTA for at least two reasons. First, to meet energy needs and environmental concerns in the fast-expanding border area, U.S. natural gas piped across the border to Mexico has quadrupled since 1990.[54] An average of 170 million cubic feet per day was exported to Mexico in 1991.[55] Secondly, and more importantly, the negotiating process of the NAFTA offers the U.S. oil industry an opportunity to gain access to the Mexican oil business. Currently, the Mexican constitution restricts petroleum ownership to Mexican nationals. Although this restriction is not uncommon, Mexico goes a step further by specifically prohibiting payment with crude. Mexico risks becoming an oil-importing country in the near future if new production capabilities are not developed. American oil companies would gladly help if they could get paid in crude--the normal payment in these type transactions. Given these circumstances, it is not surprising that the U.S. oil industry supports the FTA. It is actively urging negotiators to push harder for trade liberalization with Mexico's state-owned oil monopoly. The Wall Street Journal reports that the U.S.

provided this message at the free trade negotiations in January: lubricate the passage of the FTA with petroleum opportunities for U.S. companies.[56] In short, even if the "lubrication" is not part of the FTA, the U.S. oil industry sees increased profits as the growing Mexican economy demands even more imported gas from the U.S. This demand would increase if the FTA produces even more growth in the Mexican economy as predicted.[57]

Manufacturing and other industries represent another powerful group that supports the FTA. In general terms, industry benefits in two ways. First, a growing Mexican economy, enhanced by the free trade agreement, means a bigger export market for the products of U.S. industry. Secondly, by keeping its high technology in the U.S. and exporting the unskilled jobs to the cheaper labor market in Mexico, American industries can better compete in the international marketplace. Free trade with Mexico facilitates this arrangement. The vast array of U.S. industries that already have production and assembly plants in Mexico testifies to the benefits that could only be expanded under the NAFTA.

The last group, admittedly small, that supports the FTA consists of the leaders of the U.S., Mexico, and Canada. Presidents Salinas and Bush have met over eight times since they took office to discuss the free trade issue. Further, there have been numerous telephone summits between the two Presidents. Canadian Prime Minister Mulroney also supports the agreement, despite recent setbacks in U.S.-Canadian trade relations concerning the importation of automobiles assembled in Canada

and the dumping of alleged subsidized Canadian lumber on the U.S. market.[58] These recent setbacks offer the Canadians an opportunity at the FTA negotiations to eliminate these and other shortfalls in the current free trade agreement between the U.S. and Canada signed in 1989.

Weighing the support both for and against, I believe the FTA will be approved when it comes up for passage in the Congress for the following reasons. The President and the free traders in Congress are ahead of the protectionists: two wins and no losses. The wins include the free trade agreement between Canada and the U.S. passed by Congress in 1989 and the Congressional approval to pursue fast-track negotiations with Mexico in 1990. But the political mood can shift a lot in a very short time, so two questions bear watching. First, how much influence from the Buchanan supporters in the Republican party can be exerted on the President to go slow on the free trade issue? Second, with a big turnover in Congress after this upcoming election, can the President rally enough free trade Democrats to ensure passage? Even so, some pundits believe that a vote could be requested before the November election. A recent editorial in the Financial Times suggests that an early FTA might provide a much-needed pre-election coup.[59] But, to risk a vote prior to the elections, the President would have to be either desperate or so confident of victory that the risk would be negligible. I do not believe either situation will occur. Rather, I see a vote after the election, even if President Bush should lose. Fast track authorization expires in

June of 1993. If the FTA is not brought to a vote by that time, I believe the agreement would then be in jeopardy of dying a slow, neglected death.

In a worse-case scenario, what happens if the FTA is not approved by Congress or is not even voted upon? Granted, the odds appear to be small of this happening, but such an outcome would have potentially devastating effects on Mexico and other Latin American countries. Certainly, a no-vote would indicate a more protectionist mood in Congress. As mentioned earlier, Canada and Mexico sought a FTA in large part to stem the tide of rising protectionism. Could Mexico recover from this negative vote? Or would this no-vote threaten the very survival of the PRI by undercutting the economic policies of President Salinas? One school of thought believes the FTA is just the icing on the cake. They see capital flowing into Mexico because investors can see it has changed.[60] I tend to lean in this direction. Foreign investments are being pumped into Mexico because of its track record, not because of the pending FTA. However, given the risks involved, I fully understand the position of President Salinas. The FTA, at a minimum, would keep the flow of investments steady and should, in fact, give foreign investments a boost.

Assuming approval of the FTA sometime before June of 1993, what follows? As the linchpin of a hemisphere-wide free trade zone, the signing of the agreement shifts the focus further south. The reality of a hemisphere-wide trade zone depends heavily on the continued health of fragile democracies and the

continued trend in open markets and privatization. The movement in this direction will probably be slow. Dr. Krugman's argument--that free trade between neighbors is beneficial, but that the prospect of free trade between neighbors interdispersed from Alaska to the Antarctica is not--rings in our ears. We hear much talk about a North-South economic alliance to match the EC; even a North American monetary unit may be in the eyes of some regional enthusiasts.[61] The quest for a New World Order recognizes the strength of the EC and Japan's growing Asian-Pacific empire. This recognition spurs the U.S. to continue to push the EAI and hemisphere-wide free trade.

## CONCLUSIONS

I believe the FTA will be approved by Congress in early 1993. However, this agreement is not a panacea. Consider the recent problems in the U.S.-Canadian free trade agreement. But it will provide the framework not only to solve issues that arise periodically, but also to move each country closer to free trade over time. In terms of who gains the most from the FTA, Mexico clearly comes out on top. However, peripheral benefits combined with marginal trade benefits make the U.S. a winner as well. These peripheral benefits include a stronger neighbor, a more supportive neighbor. Increased cooperation in trade has already spilled over into other areas. Mexico's desire to consummate the agreement has helped us address environmental issues along the border and may help the U.S.'s oil industry reach new trading terms--payment in crude for services rendered

--common elsewhere in Latin America. Passage of the FTA may stem the tide of rising protectionism in the U.S. and eventually eliminate the last non-tariff restrictions in this country. The benefit to U.S. trade and U.S. consumers should be further enhanced as the U.S.--which already has fewer restrictions than either the EC or Japan--moves away from a policy of "fair" trade to free trade.

## ENDNOTES


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